No. 79-2054

Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

HARRY LEWIS, ALFRED B. REISS, CAROLA GRUEN, as Executrix of the estate of her late husband, Theodore Gruen, IRA BARMAK and COLONIAL SECURITIES CORPORATION,

Petitioners,

v.

HAROLD W. MCGRAW, JR., JOHN L. MCGRAW, DANIEL F. CROWLEY, PETER O. LAWSON-JOHNSTON, KAY K. MAZUY, WILLIAM J. MCGILL, GORDON W. MCKINLEY, ALAN J. PIFER, LOUIS PUTZE, HAROLD S. TUTHILL, JAMES E. WEBB, VERNON R. ALDEN, GEORGE R. WEBSTER and MCGRAW-HILL, INC.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM IN RESPONSE TO PETITION FOR A WRIT OF CERTIORARI

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MEMORANDUM IN RESPONSE TO PETITION FOR A WRIT OF CERTIORARI

Preliminary Statement

Petitioners seek certiorari to review the judgment of the United States Court of Appeals for the Second Circuit which affirmed an Order and Judgment of the United States District Court for the Southern District of New York, Honorable

Constance Baker Motley, District Judge, dismissing consolidated actions for lack of subject matter jurisdiction and for failure to state a federal claim. The actions, brought against respondent McGraw-Hill, Inc. ("McGraw-Hill") and its directors, the individual respondents, sought damages on behalf of an asserted class of McGraw-Hill shareholders by virtue of respondents' rejection of a proposed tender offer by American Express Company ("Amexco") for all of the stock of McGraw-Hill. The proposed tender offer was abandoned by Amexco without ever having commenced. The action was purported to be based upon Section 14(e) of the Securities Exchange Act of 1934 with pendent claims that respondents allegedly breached common-law fiduciary duties to the class in rejecting the Amexco proposals.

Respondents choose to take no position as to whether this Court should grant certiorari in this matter.* Respondents did not originally submit a response to the certiorari petition. By letter dated September 11, 1980, the Clerk of this Court notified respondents' counsel that the Court had directed that a request be made of respondents to file a response. In compliance with that request, respondents respectfully submit the present memorandum which will endeavor to set forth factors which this Court may deem germane to its determination as to whether or not to grant certiorari.

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* There are presently pending in the New York State Supreme Court, New York County, four consolidated class actions—three brought by the same plaintiffs as commenced the actions below—which essentially duplicate the claims asserted against respondents in the District Court. Plaintiffs in the state-court action are represented by the same lead counsel as appears for plaintiffs in the federal courts. By stipulation among the parties, all proceedings in the state-court actions have essentially been stayed pending final determination by the federal courts of respondents' dismissal motion. Thus, a grant of certiorari by this Court would effectively operate to continue the present stay of the New York state-court actions.

QUESTIONS PRESENTED

Respondents submit that the "question presented" by petitioners should be restated as follows:

1. Did the Court of Appeals correctly hold that shareholders of a target company could not maintain a cause of action for damages under the Williams Act, Section 14(e), where it is conceded that no tender offer was ever made, that the shareholders were never confronted with an investment decision as to whether or not to tender their shares, and that the shareholders never relied upon the "deceptions" alleged?* See Point I *infra*.

Were certiorari to be granted herein, respondents (in supporting the judgment under review) would tender the following additional questions for resolution by the Court:

2. Can this Court's holding in *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 477 (1977), that the fraud provisions of the Securities Exchange Act (there Section 10(b) and Rule 10b-5) do not reach cases "in which the essence of the complaint is that shareholders were treated unfairly by a fiduciary" be circumvented by inclusion in a federal court complaint of "bootstrap" allegations of "fraud" consisting in essence of nothing more than a claim that defendants failed to disclose their supposed breach of fiduciary duties? See Point II *infra*.

3. Does Section 14(e) give rise to *any* implied private cause of action for damages? See Point III *infra*.

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* Petitioners' "question presented" (Petition, p. 2) imputes "manipulative" practices to respondents as well. Petitioners' complaint (*quoted in Lewis* v. *McGraw*, 619 F.2d 192, 194 (2d Cir. 1980)), however, alleges no conduct which could conceivably qualify as "manipulative" within this Court's decisions. See *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 476-77 (1977); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 199 & n.21 (1976).

STATEMENT OF THE CASE

Respondents believe that a brief review of the nature of the case and the prior proceedings—both state and federal—would be helpful to this Court in placing in context the issues raised by the certiorari petition.

A. The Amexco takeover proposals.

The actions below arose out of two takeover proposals for McGraw-Hill made by Amexco in early 1979. The first consisted of a proposed "hostile" takeover by Amexco, which announced its intention on January 16, 1979 to make a tender offer to McGraw-Hill shareholders at a price of $34 per share. This proposed tender offer was unanimously determined by the McGraw-Hill Board of Directors to be grossly inadequate in price, to raise serious legal questions, and to be contrary to the best interests of McGraw-Hill and its shareholders.*

The Amexco proposed tender offer accordingly came under litigation challenge by McGraw-Hill both in the United States District Court for the Southern District of New York and in the New York State Supreme Court. In addition, the proposed acquisition of McGraw-Hill—a major American publishing, journalism, broadcasting and financial information company—by an international financial and banking institution such as Amexco was met with widespread opposition in the press and from authors, editors and customers upon whom McGraw-Hill was dependent for its business existence. The proposed transaction also came under scrutiny from concerned governmental agencies, including the Federal Trade Commission.

On January 29, 1979, Amexco withdrew its $34 proposal for McGraw-Hill, only minutes before deposition testimony of key Amexco executives was to commence. In its place,

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* By virtue of a state-court preliminary injunction motion made and then withdrawn by plaintiff shareholders, see pp. 6-8 *infra*, a detailed evidentiary showing was made of record by respondents of the facts that transpired in this matter.

Amexco announced a new plan—a "friendly" proposed tender offer for McGraw-Hill at $40 per share conditioned, however, upon the McGraw-Hill Board of Directors' either recommending the proposal or interposing no opposition whatsoever "by propaganda, lobbying, litigation or otherwise."

The revised Amexco proposal received careful consideration from the Board of Directors of McGraw-Hill, which unanimously determined that it was financially inadequate, legally dubious and uncertain of consummation.

Subsequent to this rejection of its "friendly" proposal, Amexco announced that it would leave its proposal "open" until March 1, 1979, the stated premise being that McGraw-Hill might change its mind. The proposal then was permitted to expire on March 1.

B. The state and federal court actions.

The directors' determinations were challenged in a series of purported class actions by the present petitioners and others. The initial action was brought by petitioner Lewis in New York State Supreme Court and was followed two weeks later by an action in the District Court by the same petitioner, alleging not only state-law claims but a Section 14(e) claim as well. The *Lewis* actions were then followed by successive actions in state court and in the District Court below by the other petitioners.

All of the complaints, state and federal, sought to hold the director-respondents liable in damages charging that they had violated their state-law fiduciary duties by rejecting the Amexco proposals, by actively opposing them, and by not negotiating to sell McGraw-Hill to Amexco. The federal-court complaints also alleged that the directors had violated Section 14(e) of the Securities Exchange Act by virtue of allegedly "fraudulent" misstatements. Certain of the state-court complaints contain rather similar claims of common-law fraud.

C. Plaintiffs' preliminary injunction motion in the state court.

On February 9, 1979, while the second, "friendly" Amexco proposal was still open, a motion for a "preliminary mandatory injunction" on behalf of the class of McGraw-Hill shareholders was brought on in state court by order to show cause, seeking in substance to compel the defendant directors to accept the Amexco "friendly" $40 per share proposed transaction.

Defendants filed full answering papers—a comprehensive affidavit, documentary exhibits and a memorandum of law—demonstrating beyond doubt that the motion (and, indeed, the underlying action as well) was without either legal or factual merit. Thus, on the motion, defendants showed that the McGraw-Hill Board consisted overwhelmingly of distinguished, independent, "outside" directors in no way beholden to McGraw-Hill's management. It was further set forth that the Board had acted only after receiving expert advice from an independent investment banking firm and two outside law firms. And defendants made a detailed evidentiary showing that, after exhaustive consideration, the directors had unanimously determined in their reasonable business judgment that to consent to the Amexco proposal would be contrary to the best interests of McGraw-Hill and its stockholders for a number of reasons, the principal ones being:

— The Board had received independent investment banking advice from the firm of Morgan Stanley & Co., Inc., that, because the future prospects of McGraw-Hill as an independent entity were extremely bright and it was likely to experience excellent growth and market acceptance in the 1980s, it was not the appropriate time to sell or merge McGraw-Hill;

— The Board had received Morgan Stanley's considered opinion that the $40 price at which Amexco was making its proposal was an inadequate one for a sale of the enterprise even were it desired that

McGraw-Hill be sold at that time, and that a higher price could be obtained from others;

— The Board had received independent legal advice from two outside law firms that, in light of the serious questions of illegality raised by an Amexco/McGraw-Hill combination, any Amexco tender offer for McGraw-Hill—even if not opposed by McGraw-Hill—was virtually certain of being long delayed by governmental agencies with strong likelihood of ultimate withdrawal or prohibition; and

— The Board had concluded that, given the nature of McGraw-Hill's business, there was a grave risk that McGraw-Hill would be seriously damaged during the interim period of uncertainty as to the future of the company and that if, as anticipated, the Amexco offer ultimately failed of consummation, the shareholders would not only *not* receive the $40 price, but would be left owning "damaged goods."

In sum, it was shown in opposition to the state-court injunction motion that the Board had concluded that to accept the Amexco proposal was to place McGraw-Hill's business at risk of serious damage during what promised to be a lengthy and likely futile quest to obtain an inadequate price.*

The state-court motion initially came on to be heard before a Justice of the Supreme Court on February 22, 1979. In the face of the overwhelming evidentiary showing submitted by

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* The accuracy of the Board's conclusion that the $40 price being proposed in early 1979 by Amexco for a takeover of McGraw-Hill was inadequate has been borne out by subsequent events. As set forth by petitioners, prior to the initial Amexco proposal, McGraw-Hill shares had been trading at approximately $25 per share. As this brief is being written in October 1980, McGraw-Hill shares were trading at $39-7/8 in ordinary market transactions upon the New York Stock Exchange, *Wall Street Journal*, Oct. 7, 1980, at 52, col. 5, and were it deemed appropriate to sell the enterprise as a whole, a markedly higher takeover price would be readily obtainable.

defendants in their answering papers, plaintiffs chose to withdraw the motion rather than permit it to be heard by the state court.

D. Respondents' motion in the District Court.

Respondents moved the District Court to dismiss petitioners' Consolidated Amended Complaint. The basis of the motion was that the complaint failed to state a claim cognizable under Section 14(e) and that, federal jurisdiction being absent, the pendent state-law claims were likewise required to be dismissed.

In support of their motion below, respondents set forth for the District Court that:

1. The essence of petitioners' complaint was nothing more than a claim of supposed breach by respondents of their state-law fiduciary duties as directors, which claim was not cognizable by a federal court under *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977), notwithstanding petitioners' "bootstrap" allegations of "deception" designed to circumvent the holding of *Santa Fe*;

2. Petitioners had not, and could not, allege that they (or anyone else) had relied upon any "misrepresentations" to their detriment: petitioners' "deception" allegations thus floated weightless in a vacuum neither relied upon nor causal of any "damages"; and

3. The proposed Amexco tender offer having been withdrawn by Amexco before it ever commenced, petitioners necessarily were unable to satisfy Section 14(e)'s requirement that the conduct for which they sought damages had occurred "in connection with" a tender offer.

By Memorandum Opinion and Order filed November 30, 1979, Judge Motley of the Southern District of New York granted respondents' motion to dismiss. *Lewis* v. *McGraw*,

[1979-80 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 97,195 (S.D.N.Y. 1979). In her opinion, Judge Motley expressly rejected respondents' "*Santa Fe*" and "in connection with" positions. *Id.* at 96,567-69. Judge Motley nevertheless agreed with respondents that petitioners' complaint was fatally defective in failing to allege reliance and causation as required under Section 14(e). *Id.* at 96,570. Judge Motley held:

> While plaintiffs do allege deception on the part of defendants, plaintiffs do not allege that anyone was deceived or that anyone acted in reliance upon the alleged deception to their detriment. . . .
>
> . . . .
>
> . . . Plaintiffs allege neither reliance on the part of stockholders nor reliance on the part of AMEXCO—in fact, any suggestion that AMEXCO withdrew its proposed tender offer in *reliance* upon the alleged McGraw-Hill misrepresentations and omissions would be absurd. Even assuming that misrepresentations or omissions thwarted the proposed AMEXCO tender offer, such an allegation would not give rise to a Section 14(e) violation.
>
> *Id.* (emphasis in original).

E. Petitioners' appeal to the Second Circuit.

Petitioners took appeal to the Second Circuit from the District Court's dismissal of the action. Respondents in the Second Circuit relied upon all of the grounds for dismissal previously urged before the District Court. Respondents also "noted in passing" to the Second Circuit that recent decisions of this Court strongly suggest that no damage action of any kind is necessarily implicit in Section 14(e). The appeal came on before then Chief Judge Kaufman, Circuit Judge Meskill and District Judge Brieant, sitting by designation.

The Second Circuit on April 3, 1980, unanimously affirmed the District Court's determination. *Lewis* v. *McGraw*, 619 F.2d 192 (2d Cir. 1980) (per curiam). The Court of Appeals

agreed with the District Court that—in light of the conceded fact that no tender offer ever took place and no McGraw-Hill shareholder was ever in a position to offer his shares to Amexco—"the target's shareholders simply could not have relied upon McGraw-Hill's statements, whether true or false, since they were never given an opportunity to tender their shares", and that "no reliance was possible under any imaginable set of facts." *Id.* at 195. The Court of Appeals' opinion also appears to accept respondents' argument that, in the context of an after-the-fact suit for money damages where no tender offer has ever taken place, petitioners cannot satisfy the "in connection with any tender offer" requirement of Section 14(e). See *id.* and 15n.* *infra*. The Second Circuit indicated, however, that in its view the "in connection with" requirement *could* be satisfied in cases posing hypothetical factual circumstances not presented by the case at bar: (a) actions seeking pre-tender offer *injunctive* relief; and (b) actions seeking money damages on account of pre-tender offer fraudulent conduct where the offer ultimately *does* become effective and the fraudulent conduct can be found to have impacted the subsequent decision-making by shareholders. *Id.*

DISCUSSION

POINT I

The Second Circuit's decision is clearly correct and is in full accord with the decisions of this Court.

Petitioners urge that certiorari should be granted herein because this Court "has not yet decided at what stage of a tender offer the protection of the Williams Act begins." (Petition, p. 7.) Respondents agree that this precise issue has never been determined by this Court.

Nevertheless, it is submitted that the decision of the Court of Appeals is in full accord with prior precedents of this Court interpreting the various provisions of the securities laws and is likewise in full conformity with holdings of other Courts of Appeals as well as District Courts.

Indeed, the Second Circuit could not have reached any other conclusion in this matter without contravening any number of this Court's prior rulings as well as authoritative precedents of the lower federal courts:

1. This Court's *Chris-Craft* decision.

In *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 35 (1977), after carefully reviewing the language and history of the Williams Act, this Court held:

> [T]he *sole* purpose of the Williams Act was the protection of investors *who are confronted with a tender offer.* As we stated in *Rondeau* v. *Mosinee Paper Corp.* [422 U.S. 49, 58 (1975)]: "The purpose of the Williams Act is to insure that public shareholders who are confronted by a cash tender offer for their stock will not be required to respond without adequate information . . . ."
>
> (Emphasis supplied.)

The legislative history of Section 14(e) is precisely to the same effect: the statute protects shareholders, but *only* those shareholders who must decide whether or not to tender.* In *Chris-Craft*, on the facts there presented, this Court held that Chris-Craft—although a shareholder of a company subject to an actual tender offer—had no "implied" Section 14(e) damage claim because it was confronted with no tender offer investment decision. As this Court explained:

> As a tender offeror actively engaged in competing for Piper stock, *Chris-Craft was not in the posture of a target shareholder confronted with the decision of whether to tender or retain his stock.* Consequently, Chris-Craft could scarcely have alleged a need for the disclosures mandated by the Williams Act. In short, the fact that Chris-Craft necessarily acquired Piper stock as a means of taking over Piper adds nothing to its § 14(e) standing arguments.
>
> *Id.* at 35-36 (emphasis supplied; footnote omitted).

Since it is a given in the case at bar that the proposed Amexco tender offer for McGraw-Hill never in fact eventuated, the present petitioners were no more faced with a tender offer investment decision than was Chris-Craft; under this Court's reading of Section 14(e), then, it is submitted that petitioners can no more have a Section 14(e) damage claim than did Chris-Craft.

2. The lack of any reliance.

As the Second Circuit correctly pointed out—and petitioners have never disputed—"one element of a cause of action under § 14(e) is a showing 'that there was misrepresentation upon

* The legislative history is replete with statements emphasizing that the fundamental aim of the statute is to assist shareholders confronted with a tender offer in making "a decision whether to accept or reject the tender offer" or "the investment decision—whether to retain the security or sell it." See, *e.g.*, S. Rep. No. 550, 90th Cong., 1st Sess. 2-3 (1967); H.R. Rep. No. 1711, 90th Cong., 2d Sess. 2-3 (1968), *reprinted in* [1968] U.S. Code Cong. & Ad. News 2811, 2812-13.

which the target corporation shareholders *relied*.' " 619 F.2d at 195 (*quoting Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973); footnote omitted). And the Second Circuit was further indisputably correct in its common-sense conclusion that: "In the instant case, the target's shareholders simply could not have relied upon McGraw-Hill's statements, whether true or false, since they were never given an opportunity to tender their shares"; "no reliance was possible under any imaginable set of facts." *Id.* Petitioners below, however, citing *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128 (1972), contended that they were excused from pleading reliance because that element is "presumed" once the omission of a "material" fact is shown. This argument was quite correctly rejected by both the District Court and the Court of Appeals in that the *Ute* presumption is not remotely applicable to the case at bar. For the express premise of *Ute* is that investors were forced to make investment decisions without disclosure of "material facts that reasonably could have been expected to influence their decisions to sell." *Id.* at 153. As this Court in *Ute* formulated the presumption:

> Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a *reasonable investor might have considered them important in the making of this decision* [to sell the UDC stock].
>
> *Id.* at 153-54 (emphasis supplied).*

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* Indeed, petitioners' bland assumption of "materiality" is itself highly questionable under the precedents. Thus, this Court's definition of materiality in the proxy context in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976) that an "omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote," presupposes the occurrence of a "vote." See also *Maldonado* v. *Flynn*, 597 F.2d 789, 795-96 (2d Cir. 1979) (false statement cannot be "material" under proxy laws unless shareholders are in fact being called upon to cast a vote). The test of "materiality" for

In other words, under the *Ute* rationale, where an investor was in fact engaged in "the making of [an investment] decision", he may under certain circumstances be "presumed" to have relied upon material nondisclosure. But manifestly that rationale has no applicability whatsoever in a case such as that at bar where neither petitioners nor any other McGraw-Hill shareholders were ever called upon to make an investment decision with respect to the proposed Amexco tender offer which never took place. As the Second Circuit accurately reasoned:

> These cases [of the Supreme Court], however, in presuming reliance, did not abolish it as an element of the cause of action. Rather, they held that in cases in which reliance is possible, and even likely, but is unduly burdensome to prove, the resulting doubt would be resolved in favor of the class the statute was designed to

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Section 14(e)'s tender offer provisions parallels that under Section 14(a)'s proxy provisions. See, *e.g.*, *Seaboard World Airlines, Inc.* v. *Tiger International, Inc.*, 600 F.2d 355, 360-61 (2d Cir. 1979). The Second Circuit there ruled that under Section 14(e) itself "a misstatement or omission is ' "material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding" ' whether to accept the tender offer", thereby recognizing that "materiality" can only exist when a shareholder is in fact being called upon to make an investment decision whether to tender. 600 F.2d at 361 (*quoting* the *TSC* definition of materiality as excerpted in *Prudent Real Estate Trust* v. *Johncamp Realty, Inc.*, 599 F.2d 1140, 1146 (2d Cir. 1979); footnote omitted).

Similarly, if the issue is phrased in terms of "causation", it could not be contended that it was the alleged "deception" that "caused" Amexco to abandon its proposal. As the District Court correctly set forth:

> [A]ny suggestion that AMEXCO withdrew its proposed tender offer in *reliance* upon the alleged McGraw-Hill representations and omissions would be absurd.
>
> (Emphasis in original.)

The District Court's conclusion that petitioners could not rationally establish legal causation is in full accord with the views of other courts that have had occasion to focus on the question in like circumstances. See, *e.g.*, *Rediker* v. *Geon Industries, Inc.*, 464 F. Supp. 73, 82 (S.D.N.Y. 1978); *Altman* v. *Knight*, 431 F. Supp. 309, 314 (S.D.N.Y. 1977); *Hundahl* v. *United Benefit Life Insurance Co.*, 465 F. Supp. 1349, 1369-70 (N.D. Tex. 1979).

> protect. [*Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375, 385 (1970).] We therefore presume reliance only "where it is logical" to do so. [*Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 480 F.2d 341, 375 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973).] Here, where no reliance was possible under any imaginable set of facts, such a presumption would be illogical in the extreme.
>
> 619 F.2d at 195.

3. "In connection with."

In seeking to ascertain the proper bounds of any "implied" damage remedy under Section 14(e), the starting point must be the plain language of Section 14(e) itself. *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 24 (1977). Section 14(e) by its terms is limited to conduct

> *in connection with any tender offer* or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of *any such offer*, request, or invitation.
>
> 15 U.S.C. § 78n(e)
> (emphasis supplied).

This congressional language clearly presupposes the existence of an actual, effective "tender offer". Nothing in the statute's terms purports to extend its reach to *proposed* tender offers, like Amexco's, which in ultimate fact are *never made*. And the Second Circuit—in the after-the-fact damage context of the present action—quite correctly declined to read any such extension into the statute.* In this connection, it may be noted

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* The Second Circuit in its *per curiam* opinion did not explicitly hold that petitioners' complaint was subject to dismissal for failure to satisfy the "in connection with" requirement of Section 14(e). Nonetheless, such holding would appear to be a clear implication from the opinion. Thus: (1) the opinion distinguishes the case at bar from other hypothetical factual situations in which the Second Circuit states the "in connection with a tender offer" requirement *could* be met (619 F.2d at 195); and (2) the Second Circuit concludes its opinion with the statement "since American Express never made its proposed offer to the shareholders of McGraw-Hill, plaintiffs cannot state a cause of action for alleged misstatements under the Williams Act." *Id.* at 195-96.

again that in *Chris-Craft*, 430 U.S. at 35, this Court set forth that: "[T]he *sole* purpose of the Williams Act was the protection of investors *who are confronted with a tender offer*." (Emphasis supplied.) As noted,* this reading of Section 14(e) is in full accord with its legislative history. Thus, under the plain language of Section 14(e) as well as its legislative history and authoritative construction by this Court, no tender offer ever having taken place, defendants' supposed misconduct could not be "in connection with" a "tender offer".* *

4. This Court's *Blue Chip* decision.

Section 14(e)'s "in connection with any tender offer" clause has a well-known predecessor and close cognate in Rule 10b-5's clause requiring that the conduct proscribed by that Rule be "in connection with the purchase or sale of any security."* * * It is now quite settled that Rule 10b-5's "in connection with" requirement is to be strictly enforced in damage actions brought under that Rule: the plaintiff in such

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* See 12n.* *supra*.

* * It should be noted that in a footnote in a subsequent *amicus* brief in the Seventh Circuit, Brief of the Securities and Exchange Commission, 20 n.25, *Weiss* v. *Marshall Field & Co.*, Nos. 80-1375, 80-1389 (7th Cir., appeals docketed March 21 and 24, 1980), the Securities and Exchange Commission has expressed the view that the Second Circuit's opinion in the present case should be narrowly read to rest upon issues of absence of "reliance" and "causation" only. With respect to the "in connection with" issue, the SEC's *amicus* brief states:

> In any event, if the *Lewis* decision is read as holding that Section 14(e) does not extend to deception in connection with tender offer proposals where shareholders are not given an opportunity to tender to the bidder, the Commission submits that the decision is in error.
>
> *Id.* at 21 n.25.

* * * Except for the different wording of their "in connection with" clauses, Section 14(e) and Rule 10b-5 are, of course, substantially identical. Compare 15 U.S.C. § 78n(e) with 17 C.F.R. § 240.10b-5. See *Seaboard World Airlines, Inc.* v. *Tiger International, Inc.*, 600 F.2d 355, 358 n.3 (2d Cir. 1979); *Electronic Specialty Co.* v. *International Controls Corp.*, 409 F.2d 937, 940-41 (2d Cir. 1969).

an action must show that he is a purchaser or seller of a security; it simply will not suffice for a Rule 10b-5 plaintiff to show that a defendant caused him *not* to purchase, or *not* to sell, a security. That is, of course, the teaching of this Court's decision in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), where it was held that fraudulent misrepresentations which succeeded in preventing a "purchase" of a security from ever taking place did not thereby give rise to any violation of Rule 10b-5. *Id.* at 752-55. See also, *e.g.*, *Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F.2d 963, 966-69 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970); *Greenstein* v. *Paul*, 400 F.2d 580, 581 (2d Cir. 1968); *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F.2d 540, 544 & n.14 (2d Cir. 1967); *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461, 462-63 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952). Thus, existing Rule 10b-5 "in connection with" doctrine, if analogically applied here, independently compelled dismissal of petitioners' Section 14(e) claim: if "fraud" which prevents a purchase of securities from taking place is not "in connection with" the purchase of a security, then "fraud" which prevents a tender offer from taking place is not "in connection with" a tender offer.

5. The *Applied Digital* decision.

In their certiorari petition, petitioners appear to contend that the Second Circuit's decision is in conflict with a decision of Judge Weinfeld of the Southern District of New York in *Applied Digital Data Systems Inc.* v. *Milgo Electronic Corp.*, 425 F. Supp. 1145 (S.D.N.Y. 1977), allowing Section 14(e) to be invoked, upon an *injunction* motion, where a proposed tender offer, albeit imminent, had not yet taken place. See Petition, pp. 7-8. There is no conflict: indeed, the opinion of the Second Circuit expressly notes that Court's *agreement* with Judge Weinfeld's view in *Applied Digital*. 619 F.2d at 195. The *Applied Digital* case is simply inapposite to the present petitioners' after-the-fact action for *damages*. The injunction-

damages distinction, repeatedly enunciated by the courts in this area of the law, is here determinative.*

In *Applied Digital*, Judge Weinfeld granted the motion of a prospective tender offeror for a Section 14(e) preliminary injunction to restrain a target corporation from issuing a substantial block of stock to a friendly party in an alleged bad-faith effort to thwart the proposed tender offer. While the tender offer had not yet technically commenced, the movant demonstrated to Judge Weinfeld's satisfaction: (1) that the commencement of the tender offer in fact was "imminent"; (2) that substantial evidence supported the movant's contention that the target company's plan to issue the stock in question actually was a bad-faith maneuver designed to interfere with the proposed tender offer; and (3) that the "balance of hardships" tipped decidedly in the movant's favor. *Id.* at 1154, 1158-59, 1161-62.

The *Applied Digital* decision is undoubtedly correct: a request for a preliminary injunction necessarily addresses the *future*. Accordingly, a judge faced with a "good faith" proposal to make an "imminent" tender offer, *id.* at 1154, can only assume (absent any contrary indications, of which there were none in *Applied Digital*) that the proposed tender offer in due course will become an actual tender offer. Further, it is obvious that pre-tender offer conduct directed at a proposed offer may, when the offer attains actuality, affect the investment decision which then will confront the

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* In *Chris-Craft*, this Court expressly recognized the importance of the injunction-damages distinction in this area. Although refusing to imply an after-the-fact damage action under Section 14(e) in favor of a defeated tender offeror, this Court approvingly cited the Circuit's decision in *Electronic Specialty Co.* v. *International Controls Corp.*, 409 F.2d 937, 947 (2d Cir. 1969), which permitted a target corporation and a non-tendering shareholder-offeree to seek an injunction under Section 14(e) and expressly quoted Judge Friendly's observation there that "in corporate control contests the stage of preliminary injunctive relief, *rather than post-contest lawsuits*, 'is the time when relief can best be given.' " 430 U.S. at 42 (emphasis supplied). Thus, the distinction between injunctive and compensatory relief is critical to the scope of Section 14(e).

shareholder-offerees—the very investment decision the integrity of which the Williams Act is concerned to protect. As Judge Weinfeld observed in *Applied Digital*:

> Although the shareholders might not in the pre-offer period be faced with a present decision whether to exchange their stock in the target corporation, statements and actions of the target corporation and the offeror during this period *clearly have the capacity to affect any future decision and should thus fall within the purview of the statute.*
>
> 425 F. Supp. at 1154 (emphasis supplied).

The principles which underlie *Applied Digital*, however, have nothing to do with the case that was before the Second Circuit. This case invokes the *past*, not the future: the Amexco/McGraw-Hill affair is history and we are privileged to *know* that no tender offer ever occurred. And, precisely because no tender offer occurred, the investment decision which is the focus of the Williams Act and which concerned Judge Weinfeld in *Applied Digital* never confronted petitioners or any other McGraw-Hill shareholders.

Judge Weinfeld's reasoning with respect to the "in connection with" requirement of Section 14(e) is instructive:

> There is no apparent reason why any given action may not be taken "in connection with" a development reasonably certain to take place in the future. . . . Indeed, Rule 10b-5, . . . after which section 14(e) was closely patterned, requires that a complained of action take place "in connection with the purchase or sale of a security," yet it repeatedly has been held to create a cause of action *to enjoin* purchases or sales of securities that have been *proposed but not yet effected.*
>
> 425 F. Supp. at 1153 (emphasis supplied; footnotes omitted).

And the line of cases relied upon in *Applied Digital* makes clear that it is *only* where judicial intervention is sought in order *to prevent a threatened future fraud* that the "in connection with" requirement of Rule 10b-5 may properly be "relaxed" (*i.e.*, a plaintiff need not complain of an actual purchase or sale of securities). See *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F.2d 540, 546-47 & n.25 (2d Cir. 1967); *Ruckle* v. *Roto American Corp.*, 339 F.2d 24 (2d Cir. 1964). Accord, *e.g.*, *Tully* v. *Mott Supermarkets, Inc.*, 540 F.2d 187, 194-95 (3d Cir. 1976); *Kahan* v. *Rosenstiel*, 424 F.2d 161, 173 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970); *Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F.2d 963, 968 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970); *Fuchs* v. *Swanton Corp.*, 482 F. Supp. 83, 89-90 (S.D.N.Y. 1979); *Berne Street Enterprises, Inc.* v. *American Export Isbrandtsen Co.*, [1969-1970 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 92,711, at 99,134 (S.D.N.Y. 1970) (Mansfield, J.). No such relaxation is permissible in an after-the-fact suit for damages where it is conceded that no tender offer ever took place.

POINT II

Petitioners' complaint was required to be dismissed under the principles of *Santa Fe Industries, Inc.* v. *Green.*

In *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462 (1977), this Court held that Section 10(b) of the Securities Exchange Act does not reach cases "in which the essence of the complaint is that shareholders were treated unfairly by a fiduciary", *id.* at 477, and that a Rule 10b-5 claim is stated "only if the conduct alleged can be fairly viewed as 'manipulative or deceptive' within the meaning of the statute." *Id.* at 473-74. It would appear clear that the principles of *Santa Fe* are fully applicable to actions brought under Section 14(e). See, *e.g.*, *Bucher* v. *Shumway*, [1979-80 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 97,142, at 96,299 (S.D.N.Y. 1979), *aff'd on the opinion below*, 622 F.2d 572 (2d Cir.), *cert. denied*, 49 U.S.L.W. 3247 (Oct. 6, 1980); *In re Sunshine Mining Co. Securities Litigation*, [1979-80 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 97,217, at 96,635-36 (S.D.N.Y. 1979); *Marshel* v. *AFW Fabric Corp.*, 441 F. Supp. 299, 300 (S.D.N.Y. 1977).

Since *Santa Fe*, the lower courts have repeatedly been faced with actions which have sought to circumvent this Court's holding and foist jurisdiction upon the federal courts by insertion of allegations of "deception" or "omission" in complaints which fundamentally have as their gravamen claims of breach of fiduciary duty by defendants. Generally, such attempts have been rejected by the lower courts which have ruled that, whatever other allegations are pleaded, whenever the "essence" or "central thrust" of a purported federal securities law complaint is fiduciary breach, or where the complaint "amounts to no more than" or "boils down to" such a claim, *Santa Fe* requires dismissal. See, *e.g.*, *Biesenbach* v. *Guenther*, 588 F.2d 400, 402 (3d Cir. 1978); *Hundahl* v. *United Benefit Life Insurance Co.*, 465 F. Supp. 1349, 1362 (N.D. Tex. 1979); *Bucher* v. *Shumway*, [1979-80 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 97,142, at 96,299-303 (S.D.N.Y. 1979), *aff'd on the opinion below*, 622 F.2d 572 (2d Cir.), *cert. denied*, 49 U.S.L.W. 3247 (Oct. 6, 1980); *In re Sunshine Mining Co. Securities Litigation*, [1979-80

Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 97,217, at 96,635-36 (S.D.N.Y. 1979); *Altman* v. *Knight*, 431 F. Supp. 309, 311, 313-14 (S.D.N.Y. 1977).

The issue, however, has not been free of difficulty and certain cases have tended to give a very narrow reading to this Court's *Santa Fe* holding. See, *e.g.*, dissenting opinion of Meskill, C.J., in *Goldberg* v. *Meridor*, 567 F.2d 209, 225 (2d Cir. 1977), *cert. denied*, 434 U.S. 1069 (1978); *Jones* v. *National Distillers & Chemical Corp.*, 484 F. Supp. 679, 685 (S.D.N.Y. 1979); *cf. Hundahl* v. *United Benefit Life Insurance Co.*, 465 F. Supp. 1349, 1365 (N.D. Tex. 1979).

In the case at bar, respondents contended in the District Court that petitioners' complaint in substance presented a garden-variety claim for breach of fiduciary duty by directors and that petitioners' allegations of "deception" were of a "bootstrap" nature amounting upon close analysis to nothing more than claims that respondents had failed to "disclose" that their rejection of the Amexco proposals was the product of a breach of fiduciary duty. Judge Motley in the District Court, however, citing to one of her own prior precedents and believing cases relied upon by respondents to be distinguishable, rejected this challenge to the complaint and ruled that the complaint alleged "misstatements and omissions actionable under Section 14(e)." ¶ 97,195 at 96,569. The District Court, of course, nonetheless dismissed the complaint on alternative grounds.

Petitioners in the Second Circuit renewed their challenge to the complaint on *Santa Fe* grounds. The Second Circuit, in upholding dismissal of the complaint for failure to satisfy the Section 14(e) requirements of "reliance" and "in connection with", did not comment upon the *Santa Fe* issue.

Were this Court to accept this case for review, respondents (in supporting the judgment under review) would ask this Court to make clear that its holding in *Santa Fe* cannot be subverted by mere "bootstrap" allegations of "deception" and to rule that petitioners' complaint was subject to dismissal on this ground as well.

POINT III

There is a serious question whether Section 14(e) provides a shareholder of a target company with any implied cause of action for damages.

In *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), this Court specifically held that a competing tender offeror has no implied damage action under Section 14(e). The opinion expressly left undecided whether either "shareholder-offerees" or target corporations have such an implied action. 430 U.S. at 38-39 & n.25, 42 n.28. Cf. *Stull* v. *Bayard*, 561 F.2d 429, 432 (2d Cir. 1977), *cert. denied*, 434 U.S. 1035 (1978) (assumed but did not decide that target shareholders had a right to sue under Section 14(e)). Subsequent decisions of this Court, however, strongly suggest that no damage action of any kind is necessarily implicit in Section 14(e).

In *Touche Ross & Co.* v. *Redington*, 442 U.S. 560 (1979), reversing a Second Circuit finding of an implied cause of action for damages under Section 17(a) of the Securities Exchange Act, this Court acknowledged that it had abandoned the permissive analysis for implication of private causes of action that it had employed in *J.I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) to imply a cause of action under Section 14(a). 442 U.S. at 578; see also *Cannon* v. *University of Chicago*, 441 U.S. 677, 735-36 & n.6 (1979) (Powell, J., dissenting, describes *Borak* as "unprecedented and incomprehensible" [footnote omitted]). This Court in *Redington* further explained that in recognizing an implicit damage action under Section 10(b), it "simply explicitly acquiesced in the 25-year-old acceptance by the lower federal courts of an implied action under" that section. *Id.* at 577 n.19. No such "history of longstanding lower court interpretation", *id.*, exists with respect to Section 14(e), which was not enacted until 1968.

The Court reaffirmed and perhaps stiffened its resistance to implied damage actions under the securities laws in *Transamerica Mortgage Advisors, Inc. (TAMA)* v. *Lewis*, 444 U.S. 11 (1979). *TAMA* refused to imply a cause of action

for damages under Section 206 of the Investment Advisers Act of 1940 (an antifraud statute closely resembling Section 14(e) and Rule 10b-5) notwithstanding that the plaintiff concededly belonged to the class protected by the statute. *Id.* at 18-19.

It would thus appear that there is a serious question whether Section 14(e) should be read to imply any damage action in favor of a target company shareholder. Respondents did not advance this argument to the District Court in support of dismissal. The *Redington* and *TAMA* cases were decided by this Court prior to briefing of the appeal in the Second Circuit. In their brief to the Second Circuit, respondents "noted in passing that, in light of recent specific Supreme Court holdings in securities laws cases and the trend of securities law cases in that Court, it is by no means clear that *any* state of facts will give rise to an 'implied' damage remedy under Section 14(e)." The Second Circuit, in affirming the dismissal of the complaint upon alternative grounds, did not directly comment upon the issue but in dictum indicated that in certain circumstances it believed an implied action for damages under Section 14(e) could lie in favor of an aggrieved shareholder.

Were this Court to accept this case for review, respondents would ask this Court to clarify whether Section 14(e) is to be read to give rise to any implied cause of action for damages.

SUMMARY

Respondents submit that this case was correctly decided by the Second Circuit. Should this Court determine to grant certiorari, respondents submit that the ultimate result would be affirmance of the dismissal of petitioners' complaint. Respondents choose to take no position as to whether this Court should grant certiorari in order to express its views on the various questions of statutory interpretation presented by this action.

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Respectfully submitted,

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